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SUPREME COURT, U. S.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. [redacted] 159

EGON D. AREND and MELA K. AREND,
Petitioners,

v.

PERRY DeMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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OCTOBER TERM, 1962

EGON D. AREND and MELA K. AREND,
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v.

PERRY DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON),
Respondents.

No. .....

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners Egon D. Arend and Mela K. Arend respectfully pray that a writ of certiorari be issued to the United States Court of Appeals for the Ninth Circuit to review the judgment of that Court dated January 24, 1963 (reprinted in Appendix A hereto), reversing a judgment in petitioners' favor entered in the United States District Court for the District of Oregon.

Opinions Below

The opinion of the United States Court of Appeals for the Ninth Circuit (R. 136-149) is reported at 313 F. 2d 79 (1963) and is reprinted in Appendix B hereto. The memorandum opinion of the United States District Court

for the District of Oregon granting the permanent injunction in petitioners' favor (R. 53-54) is not reported but is reprinted in Appendix C hereto. That Court's opinion denying respondents' motion for summary judgment (R. 34-41) is reported at 181 F. Supp. 761 (1962) and is reprinted in Appendix D hereto. That Court's opinion denying petitioners' summary judgment motion (R. 43) is not reported but is reprinted in Appendix E hereto.

Jurisdiction

The judgment of the Court of Appeals was entered on January 24, 1963. A petition for rehearing was denied by the Court of Appeals on February 26, 1963. The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Questions Presented

1. The Court of Appeals here reversed a District Court judgment restraining Internal Revenue employees from further examination of petitioners or third persons dealing with petitioners with respect to petitioners' tax liability for any year prior to 1955. The District Court found that petitioners' 1946 and 1948 returns and relevant papers were examined and audited by the Internal Revenue Service in 1948 and 1950, respectively, and additional assessments were levied and paid for 1946. The District Court also found that, when in August 1958 the Internal Revenue Service issued a summons to a bank for production of all records of petitioners' financial activities with respect to petitioners' alleged tax liability for 17 years going back to 1940, the statute of limitations barred any additional assessment against petitioners for any year prior to 1955

except for fraud, and the Service did not have "any reasonable grounds or other proper cause to find or suspect that any fraud existed" with respect to petitioners' returns for those years. In reversing the District Court's judgment, the Court of Appeals held that in these circumstances the District Court "lacked power" to issue the injunction in question. Was the Court of Appeals correct that the District Court lacked such power?

2. Under 26 U. S. C. §§ 7602 and 7605(b), must the Internal Revenue Service have reasonable grounds or other proper cause to find or suspect that taxpayers have committed fraud if the Service seeks a new investigation of taxpayers' returns for years which are closed by the statute of limitations absent fraud and for some of which there have been audits and an additional assessment levied and collected?

3. The finding of the District Court that there were no reasonable grounds or other proper cause to find or suspect fraud in the closed years is supported by substantial evidence, and the Court of Appeals did not purport to hold the finding to be clearly erroneous. Nonetheless, the Court of Appeals ruled that the renewed examination was not "unnecessary" under 26 U. S. C. § 7605(b). Was this ruling error in light of Rule 52(a), F. R. C. P.?

4. Does the Fourth Amendment afford taxpayers protection against renewed investigation by the Internal Revenue Service where some of the years in question have been previously audited and all of the years are closed by the statute of limitations absent fraud and the Service does not have any reasonable grounds or other proper cause to find or suspect that the taxpayers have committed fraud?

The Statutes and Rule Involved

The statutes involved are 26 U. S. C. §§ 7602 and 7605(b).

26 U. S. C. § 7602 provides:

> "EXAMINATION OF BOOKS AND WITNESSES
>
> For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—
>
> (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;
>
> (2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and
>
> (3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry."

26 U. S. C. § 7605(b) provides:

> "*Restrictions on Examination of Taxpayer.*—No taxpayer shall be subjected to unnecessary exami-

> ifation or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary."

The rule involved is Rule 52(a), F. R. C. P.:

> ". . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. . . ."

Statement of the Case

Petitioners are husband and wife, residing in Portland, Oregon (R. 45). They here sued certain employees of the Internal Revenue Service (hereinafter "respondents") and a Portland bank in the District Court for the District of Oregon. The suit was brought about by "a new investigation" of petitioners' alleged tax liability for years going back to 1940—23 years ago (R. 137). Petitioners sought an injunction restraining respondents from examining petitioners or third parties with respect to petitioners' tax liability for any year prior to 1955 and restraining the bank from disclosing information concerning transactions by or with petitioners prior to 1955 (R. 10-11). Jurisdiction was based on 28 U. S. C. § 1340 (R. 3, 55).

In 1948, an Internal Revenue deputy collector examined petitioners' 1946 return and relevant papers. As a result, additional assessments were levied and paid (R. 57). In November 1950, another Internal Revenue deputy collector audited petitioners' 1948 return and relevant papers (R. 58).

In the spring of 1957, respondent DeMasters, an Internal Revenue agent, began "a new investigation" into

petitioners' returns for the years 1940 through 1956 (R. 58, 137). He began to inquire into petitioners' net worth as reflecting their income in those years (R. 33).

Petitioners cooperated with agent DeMasters with respect to his investigation as to years not barred by the statute of limitations (R. 47, 58, 137). When the agent persisted in his inquiry into closed years and sought access to petitioners' records without limitation as to date, petitioners' attorney notified the agent that such investigation was unjustified and unnecessary and beyond his authority (*Ibid.*).

On August 14, 1958, agent DeMasters caused a summons to be served on the bank for production of records on the alleged tax liability of petitioners over a 17-year period including the years 1940-1954. It called for "all records" pertaining to financial, loan and investment activity of petitioners, their children and a sole proprietorship formerly owned by one of the petitioners (R. 56-57).

Petitioners commenced this action on August 18, 1958. The bank did not answer or otherwise appear in the action. By orders dated March 1, 1960 and July 21, 1961, the District Court denied summary judgment motions by respondents and petitioners, respectively (R. 41, 43).

In its opinion on respondents' motion, the District Court held that it properly had jurisdiction over the action. Citing decisions by the First, Fifth, and Sixth Circuits—as well as the Ninth—the Court further declared:

> "The better-reasoned cases require that the Commissioner show that there is some reasonable suspicion or probable cause to believe fraud exists prior to the court directing compliance with a summons issued by the Commissioner or his agents, or to show that there is some justifiable reason for such investigation when there has been an audit and adjustment already" (R. 39; App. D, p. 23a).

It added:

> "If there is arbitrary action on the part of the defendants, an injunction should issue to protect the plaintiffs from unreasonable and irreparable damage; however, if there is reasonable grounds to suspect fraud on the part of the taxpayers, the defendants should have the opportunity to discover such fraud during the years involved" (R. 40-41; App. D, p. 25a).

With the issues thus carefully framed, the District Court held a full hearing and, on the basis of extensive findings of fact, granted petitioners the injunction they sought.

The findings of fact included the following:

"XIII

> "The period covered by the summons involved eighteen years, the earliest of which is 1940. The period during which Commissioner could assess additional income tax against plaintiffs for any calendar year prior to 1955 has expired, except where fraud is involved."

* * *

"XV

> "The defendants immediately prior to the issuance of said summons did not have any reasonable grounds or other proper cause to find or suspect that any fraud existed with respect to any of the returns filed by the petitioners for the years that are now closed by the statute of limitations, to wit: The years prior to 1955" (R. 58-59).

On appeal, the Circuit Court reversed the judgment based on these findings (R. 150). The Circuit Court ruled

that the Fourth Amendment had no application. It also ruled that the prohibitions of 26 U. S. C. § 7605(b) do not require that the Internal Revenue Service have reasonable grounds or probable cause to suspect fraud in order to investigate into years closed by the statute of limitations absent fraud. The Court ruled that there had been a showing that the decision to proceed was not arbitrary and that "no more was required" (R. 149). As a result, while the Circuit Court rejected respondents' contention that a District Court has no power to issue an injunction of the type sought in any circumstances, the Circuit Court concluded that "the Court lacked power to do so in the circumstances of this case" (R. 136).

Reasons for Granting the Writ

1. The Standard Used By the Court of Appeals to Determine the Propriety of the Present Investigation Is Improper and Conflicts With Decisions of Other Circuits.

In reaching its decision to reverse the District Court judgment, the Court of Appeals used an improper standard for determining whether the investigation of petitioners should proceed. That improper standard clearly conflicts with decisions of other Circuits.

Two matters should be noted preliminarily.

First, the initial provision of 26 U. S. C. § 7605(b) constitutes an absolute statutory limitation on the Commissioner's basic power of investigation, and is not simply a privilege given to a taxpayer with respect to inquiries made of him personally. Both Courts below correctly so ruled on this point.* The Court of Appeals said:

*As the Court of Appeals recognized in its opinion (R. 142), there is also a conflict among the Circuits on this point—which highlights the general confusion in this area. For example, the decision of the Court below on this point conflicts with that of the

> "The command is unequivocal. We have held that it constitutes 'a limitation on the power' of the tax collecting authorities; appellants, in consequence, had 'no power to make an unnecessary examination or investigation' [citing *Martin* v. *Chandis Securities Co.*, 128 F. 2d 731, 735-36 (9th Cir. 1942)]. As we have said, if appellants violated this statutory limitation upon their power, the present suit is maintainable. The difficult problem, of course, is that of determining the scope of the limitation: what is meant by an 'unnecessary' investigation" (R. 141-142).

Second, the Court of Appeals did not purport to set aside any of the District Court's findings of fact. It did not rule any finding to be clearly erroneous. Cf. Rule 52(a), F. R. C. P. Thus, it must be taken as established that with respect to the closed years—two of which had been previously audited—respondents did not have any reasonable grounds *or other proper cause* to find or suspect fraud (R. 59).

With this background, the Court of Appeals faced "the difficult problem" of the scope of the § 7605(b) limitation and the showing necessary to permit a new investigation. The Court ruled that there need not be a showing of "probable cause, or any cause at all," to believe that there is fraud where the Commissioner seeks to investigate a return for a tax year as to which, unless fraud is shown, the statute of limitations has barred additional assessment (R. 145). The Court apparently concluded that mere "sus-

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Second Circuit in *Application of Magnus*, 299 F. 2d 335 (2d Cir.), *cert. denied*, 370 U. S. 918 (1962), which held that the § 7605(b) prohibition "applies only to inquiries made of the taxpayer personally, and does not extend to inquiries made of third persons even though concededly part of an investigation directed solely to the taxpayer's liability" (R. 142). See, also, *Application of Magnus*, 311 F. 2d 12 (2d Cir. 1962), *cert. denied*, 31 U. S. L. Week 3353 (April 29, 1963). But see *Pacific Mills* v. *Kenefick*, 99 F. 2d 188, 189 (1st Cir. 1938).

picion"—whether or not reasonable or probable or proper—is enough (*Ibid.*). All that is required is that the Commissioner "not act arbitrarily" (R. 147, 149).

This decision was erroneous and conflicts with the decisions of several other Circuits.*

For example, the First Circuit in *O'Connor* v. *O'Connell*, 253 F. 2d 365 (1st Cir. 1958), held that the IRS must establish to the Court's satisfaction that there is "probable cause to believe that the taxpayer was guilty of fraud in a statute barred year" and that a showing of a "*bona fide* suspicion of fraud" is not enough (*Id.* at 369, 370). The Circuit Court there reversed a District Court order directing compliance with a Special Agent's 1957 summons to a taxpayer with respect to his and his wife's 1943-1947 tax liabilities. The issue as phrased by the Circuit Court:

> ". . . The question is: Do the taxing authorities only need to show the enforcing court that they entertain a *bona fide* suspicion of fraud on the part of the taxpayer for those years, or must they establish to the satisfaction of the court that there is probable cause or a reasonable basis for it to believe that in those years the taxpayer perpetrated a fraud upon the revenue?" (*Id.* at 369).

The Circuit Court's answer was:

> "To make the Congressional purpose expressed in § 7605(b) to protect taxpayers from unnecessary examinations truly effective we think the Secretary or his delegate, when a court order is needed to enforce compliance with a summons to testify as to a 'closed' year, should be required to establish to the court's satisfaction that there is probable cause for an investigation into such a year" (*Id.* at 370).

*The Court of Appeals' opinion itself notes the conflict (R. 145-146, particularly n. 28).

The First Circuit expressly rejected the contention that under § 7605(b) "all that the Secretary or his delegate needs to show is the honesty of his subjective belief that fraud existed in such a year" (*Id.* at 369). To hold otherwise, said the Court, would mean that "the necessity for an examination into a closed year would for all practical purposes be left to administrative determination and § 7605(b) would be relegated to hardly more than a pious exhortation directed to the tax authorities" (*Id.* at 369-70).

In so holding, the First Circuit Court of Appeals noted that although the Second Circuit in *Application of United States (In re Carroll)*, 246 F. 2d 762 (2d Cir.), *cert. denied*, 355 U. S. 857 (1957), "found no need to answer this precise question it nevertheless gave rather detailed consideration to the conflicting authorities bearing on it" (253 F. 2d at 369).*

Subsequently, in *Lash* v. *Nighosian*, 273 F. 2d 185 (1st Cir. 1959), *cert. denied*, 362 U. S. 904 (1960), the First Circuit reaffirmed and amplified the *O'Connor* test. The District Court had ordered enforcement of a 1958 IRS summons to a corporate taxpayer with respect to its 1952-55 tax liability, on a finding that there was " 'probable cause' to believe that the taxpayer's returns for the 'closed' years were fraudulent" (273 F. 2d at 187). In affirming, the First Circuit stated:

> "In O'Connor v. O'Connell supra we used the substantially synonymous phrases, see footnote 93 of Draper v. United States, 1959, 358 U. S. 307, 310,

*In *Application of United States (In re Carroll)*, *supra*, the Second Circuit stated: "We are not now called upon to resolve the apparent conflict between the cases dealing with what the tax authorities must show to warrant examination of the taxpayer and others relative to matters which may be barred by the statute of limitations" (246 F. 2d at 765). The decisions of that Circuit are inconclusive and, as the Court below noted, have "treated the question as still open" (R. 146).

> 79 S. Ct. 329, 3 L. Ed. 2d 327, 'probable cause' and 'reasonable grounds' in their generally accepted meaning in other contexts. In using the familiar phrases we meant to imply that in ordering enforcement of a summons the district court should apply the same test that it would apply in deciding whether an arrest by an officer without a warrant, and perhaps his incidental search of the person of his prisoner, complied with constitutional or statutory requirements" (273 F. 2d at 189).

The Third Circuit decisions also conflict with that of the Circuit Court below. In *Zimmermann* v. *Wilson*, 105 F. 2d 583, 586 (3d Cir. 1939), affirming 25 F. Supp. 75 (E. D. Pa. 1938), the Court of Appeals concurred in the District Court's view that the test is one of "probable cause" or "reasonable ground of 'suspicion of fraud.'" More recently, in *Application of Hazard*, 210 F. Supp. 301 (W. D. Pa. 1962), the Court explained a decision it had rendered quashing an IRS summons as to the years 1956-1958 but not as to 1959 (a year on which the statute of limitations had not run, even absent fraud). It stated that it accepted the *Zimmermann* case

> "to the effect that when a reinvestigation is made under 26 U. S. C. § 7605(b), of a tax year as to which the statute of limitations has run except with respect to fraud violations, the mere *ipse dixit* of the internal revenue official that reexamination is 'deemed necessary' is not conclusive; that the Government must set forth facts (not mere conclusions or opinions) sufficient to convince the Court that reasonable ground exists to suspect fraud" (210 F. Supp. at 303).

The Fourth Circuit in *Wall* v. *Mitchell*, 287 F. 2d 31 (4th Cir. 1961), stated:

> "We are well aware of the conflict among the several circuits relative to the showing of suspected fraud required from the Internal Revenue Service in such cases, but we do not find it necessary to make a choice of criteria at this time. Here, the District Judge made a finding that there was probable cause to suspect fraud in connection with the income tax returns filed by the taxpayer for the years in question" (*Id.* at 31-32).

However, both earlier and subsequent District Court opinions in the Fourth Circuit support the "probable cause" requirement. *E.g., In re Andrews' Tax Liability*, 18 F. Supp. 804, 805, 807 (D. Md. 1937); *United States* v. *Austin*, 209 F. Supp. 101, 106 (M. D. N. C. 1962).

The Seventh Circuit also appears to require probable cause. In *U. S. Aluminum Siding Corp.* v. *Eshleman*, 170 F. Supp. 12 (N. D. Ill. 1958), the Court directed a hearing to determine if an IRS examination was necessary. It ruled that the IRS does not have "untrammeled discretion" and since its "discretion is limited, whether or not it has been properly exercised must be judged by the Court" (*Id.* at 14). On the question of what showing the Government must make, the Court observed:

> ". . . It is not strange that there should be disagreement on this point, since the relevant cases are not at all clear. . . .
>
> ". . . [T]he affidavits, assuming their truth, are far short of establishing reasonable grounds for suspecting fraud. They refer to 'another' government agency, and 'unconfirmed information'. This is not enough to convince the Court that there is a 'reasonable basis' for the agents' belief that fraud has been committed; and that is the requirement" (*Id.* at 15).

In *McDermott* v. *John Baumgarth Co.*, 286 F. 2d 864 (7th Cir. 1961), the District Court had found after a hearing that there were "reasonable grounds" to suspect fraud as to two of the four years covered by the "summons" there in issue and enforced the summons only as to those years. The Court of Appeals affirmed. It upheld the District Court's refusal to infer that if fraud was committed in 1951-52, some of the fraudulent practices continued in later years.

Finally, the Eighth Circuit view is reflected by *United States ex rel. Sathre* v. *Third Northwestern Nat'l Bank*, 102 F. Supp. 879, 882 (D. Minn.), appeal dismissed, 196 F. 2d 501 (8th Cir. 1952), where the Court approved the test "of whether the facts show a reasonable ground of suspicion or probable cause for the examination to ascertain if there has been fraud."

We submit that in the conflict among the Circuits, the probable cause view "is supported by the better reason." *O'Connor* v. *O'Connell*, *supra*, 253 F. 2d at 369.

The Court below regarded the § 7605(b) interdiction of "unnecessary" investigation as meaning no more than the general judicial limitations placed on enforcement of administrative subpoenas (R. 147). But the result of such a view is that the express Congressional interdiction really adds nothing to the taxpayer's protection.

The Court below relied on cases dealing with first investigations by administrative bodies (R. 144-145, 147). In so doing, the Court disregarded two vital considerations. First, after the passage of 18 years and after two audits and one additional assessment, the IRS cannot legitimately be said to be "at the threshold of inquiry." *Oklahoma Press Publishing Co.* v. *Walling*, 327 U. S. 186, 213 (1946). Second, the cases on which the Circuit Court relied did not

involve a statute such as § 7605(b) designed by Congress for the citizen's protection.

The statute in question was enacted to provide limitations with respect to new examinations many years after the fact. The expressed concern of the legislators was with "re-examination" (61 Cong. Rec. 5202), "another examination" (*ibid.*), "further examination" (*id.* at 5855), "repeated visits of tax examiners" (*ibid.*) and "unnecessarily frequent examinations and investigations by revenue agents" (S. Rep. No. 275, 67th Cong., 1st Sess. 31 (1921)). And the legislators felt that there should be "good cause for a re-examination" (61 Cong. Rec. 5202).

While the Court below professed that it is not apparent why more should be required of the Commissioner for a new examination into ancient—and once-examined—history than is required for an initial examination within the period of the statute of limitations (R. 145), it later noted that there is "a significant change in the relevant balance of public and private interests which takes place with the running of the statute of limitations" (R. 149). With the running of the statute, the Government's need for unencumbered access to facts decreases at the same time that the burden and hardship of further investigation on the taxpayer increases. As the Circuit Court below recognized:

> "The government's need for speedy and unimpeded access to the facts is diminished when the problem shifts from that of checking the accuracy of the returns of sixty million taxpayers within the relatively short period of limitations, to that of ferreting out the rare instance of liability for fraud which can never be barred by the passage of time. From the taxpayer's point of view, an inquiry which can be readily met when memories are clear and records readily available, may become difficult to satisfy

with a lapse of time, possibly extending, as in the present case, to a score or more of years" (R. 149).

The First Circuit in the *O'Connor* case, *supra*, also noted the significance of the running of the statute in reaching a conclusion opposite that of the Circuit Court below:

> "As the years pass, however, the burden of such examinations on the taxpayer increases, for memories fade, records may be lost or mislaid, indeed to conserve space honest taxpayers may well destroy their records relating to years as to which the statute of limitations has run, and persons who have assisted taxpayers in preparing their returns may die, move away, or for one reason or another be no longer available" (253 F. 2d at 369).

It then stated:

> "We may well assume that considerations such as these had weight with Congress when it legislated in § 7605(b) to curb excessive administration zeal by protecting taxpayers from unnecessary examination and investigation" (*Ibid.*).*

The requirement of "probable cause" for a belief or suspicion of fraud in otherwise closed years simply gives the taxpayer the protection which Congress intended him to have:

> "We think Congress intended to give taxpayers this much protection when the investigation of their returns may reach far back into the past, in this case fourteen years, and in some cases perhaps even

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*8 Mertens, *Law of Federal Income Taxation* § 47.48 (Cum. Supp. 1962), which praises the *O'Connor* case as "ably considered" (p. 137), also says that it contains "an excellent analysis of the considerations which Congress had in mind in enacting this provision" (p. 141).

further,* and that to require such a showing does not impose too heavy a burden upon the tax authorities or unduly restrict or hamper them in tax enforcement" (*Id.* at 370).

The inclusion of § 7605(b) in the 1954 Internal Revenue Code—the third re-enactment of provisions dating back to 1921 (42 Stat. 310 (1921))—came after several decisions holding these provisions to constitute limitations on the IRS power of investigation and adopting or approving the probable cause requirement for tax years closed absent fraud. *E.g., United States ex rel. Sathre v. Third Northwestern Nat'l Bank*, 102 F. Supp. 879 (D. Minn. 1952), appeal dismissed, 196 F. 2d 501 (8th Cir. 1952); *Martin v. Chandis Securities Co.*, 128 F. 2d 731 (9th Cir. 1942); *Zimmermann v. Wilson*, 105 F. 2d 583 (3d Cir. 1939); *Pacific Mills v. Kenefick*, 99 F. 2d 188 (1st Cir. 1938); *In re Andrews' Tax Liability*, 18 F. Supp. 804 (D. Md. 1937). This further "evidences the legislature's intent that it [§ 7605(b)] should serve to curtail the investigatory powers of the Bureau of Internal Revenue" and give the taxpayer the protection afforded by the probable cause requirement. Note, 10 Hastings L. Rev. 211, 213-14 (1958).

The basic questions here at issue—the extent of permitted IRS intrusion into an individual's affairs and the protection granted by Congress with respect to "closed" tax years—are of far-reaching and recurring significance. The *O'Connor* decision was hailed as providing a "greatly needed standard or test"—"a just result using sound legal reasoning" (*Id.* at 211, 214). The decision of the Court below now creates a clear conflict among the Circuits as to the meaning of a statute whose nation-wide application should be uniform.

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*Eighteen years in the present case; or twenty-three years from today.

2. The Reversal of the District Court's Judgment was Erroneous Even Under the Standard Adopted by the Court of Appeals.

In view of the findings made by the District Court, the reversal of that Court's judgment was erroneous even if the meaning and scope of § 7605(b) is as expressed by the Court of Appeals. That reversal necessarily violated Rule 52(a) of the Federal Rules of Civil Procedure.

The showing made to the trial Court by the Government was not sufficient to justify the "new investigation" whether judged by a "non-arbitrary" or "rational judgment" test or by a "probable cause" or "reasonable ground" test. And the District Court found not only that respondents did not have "any reasonable ground" to find or suspect fraud, but also that they did not have any "other proper cause" for such a finding or suspicion (R. 59). This finding by the Judge who heard the evidence was not set aside by the Court of Appeals, as it could not properly be under Rule 52(a).

Without any proper cause to suspect fraud, the IRS decision to proceed must be deemed to have been arbitrary. A decision not based on any proper cause cannot legitimately be said to have been reached "as a matter of rational judgment" (R. 149).

The testimony and evidence on which the trial Judge based his decision to grant petitioners equitable relief abundantly establish that this search for "the rare instance of liability for fraud" (R. 149) was supported only by conjecture and excessive zeal. For example:

1. The Government offered no indicia or evidence of fraud. Its "justification" rested in a showing of the possibility of some understatement of income in the years in question. As agent DeMasters candidly stated:

> "I do not conclude anything. I am only of the position that it is entirely possible that these taxpayers understated their income for these years" (R. 101).

He further testified that he was not satisfied in his own mind that there was any omitted income (R. 99).* In any event, the decisions of this Court reject any inference or suspicion of fraud from mere understatement of income—let alone from the possibility of such understatement. See, *e.g., Holland* v. *United States*, 348 U. S. 121 (1954).

2. The agent himself expressed doubt as to whether his figures entitled him to proceed: ". . . I was not convinced that this would give me grounds to investigate at that moment" (R. 87).

3. The agent's net worth analysis "was merely an estimate"—"no attempt is made to stand on this statement" (R. 88). DeMasters admitted that the figure he used for the taxpayers' opening net worth was "the figure that entered my head"—"purely an estimate" (R. 111).

4. Agent DeMasters further admitted that

(a) He incorrectly computed petitioners' closing mortgage liability (R. 87-88);

(b) He made no allowance for petitioners' receipt of non-taxable proceeds from a personal injury claim (R. 113);

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*It is significant to note that, assuming proper departmental practice was followed in this case, agent DeMasters must not have discovered "what he believes to be an indication of fraud" (Handbook for Internal Revenue Agents, ¶ 10.01) or "any" indication of fraud" (Internal Revenue Manual § 4567). See, also, American Bar Association, *Tax Fraud Cases—Practice and Procedure* 14 (1951).

(c) He made no allowance for funds which he had been informed petitioners brought with them to this country in 1939 and invested in assets held at the close of the period (R. 16, 89, 113-114);

(d) He made no allowance for petitioners' receipt of money from recovery of assets in Czechoslovakia in 1945 and 1948 (R. 117-118); and

(e) He did not know whether petitioners had any money in a safe deposit box at the start of the period or whether they used such money to acquire assets they said they had at the close of the period (R. 114-115).

5. Agent DeMasters conceded that the post-1950 returns all "appear to be correct," and no claim was made that an examination of closed years was needed or sought in connection with an examination of years not barred by the statute. (R. 121, 147.)

It is clear that the Government's attempted showing of "justification" runs afoul of all basic legal and logical principles for showing unreported income by a net worth approach. See, *e.g.*, *Holland* v. *United States*, 348 U. S. 121 (1954); *Thomas* v. *Commissioner*, 261 F. 2d 643 (1st Cir. 1958).

In short, the record shows no proper justification for a suspicion of unreported income, let alone of fraud. The District Court's finding of no proper cause at all to suspect fraud is amply supported by substantial evidence. And that finding necessarily means that the new investigation was improper even under the standard adopted by the Court of Appeals.

3. The Court of Appeals Erred in Ruling that the Fourth Amendment Was Not Applicable.

Petitioners contended in the District Court that they were entitled to relief from the further IRS investigation

under the Fourth Amendment, as well as under § 7605(b), because respondents' action in the circumstances of this case constituted an unreasonable search and seizure.

In reversing the District Court's judgment in favor of petitioners, the Court of Appeals ruled that the Fourth Amendment was not applicable because the IRS summons was directed to the bank and not to petitioners.*

That decision was erroneous and in conflict with a holding of the Third Circuit. *Zimmermann* v. *Wilson*, 81 F. 2d 847 (3d Cir. 1936).

The Court below recognized that "Fourth Amendment rights do not depend on nice distinctions of property law" (R. 140 n. 11). See *Jones* v. *United States*, 362 U. S. 257 (1960); *Silverman* v. *United States*, 365 U. S. 505 (1961). It ruled, however, that "the taxpayers had no interest in the bank's records of the kind the Fourth Amendment was intended to protect" (*Ibid.*). We respectfully submit that this ruling was not correct. In the Fourth Amendment sense, we believe, these documents were private papers in which petitioners had a protectible interest—they were papers concerning petitioners' own private transactions with and through fiduciaries.

In *Zimmermann* v. *Wilson*, *supra*, the Third Circuit Court of Appeals reversed a dismissal of a complaint seeking an injunction to prevent the IRS from examining papers of the taxpapers' bankers and brokers with respect to the taxpayers' financial affairs. The Court refused to be diverted by technicalities. It observed that the consequence of denying the taxpayers the protection of the Fourth Amendment would be "to give to the revenue agents infor-

*Although the Court stated that the bank "waived any right it might have had to resist production" (R. 140), the bank has not responded to the summons and did not appear in this action or contest petitioners' right to the requested relief.

mation of the private affairs of the taxpayers and, by indirection, give the government a searching power of the defendants' affairs which it cannot legally assert against the taxpayers themselves" (81 F. 2d at 849). The Court further stated:

> "We are not impressed with the contention that the granting of the injunction prayed for will cripple the hands of the taxing authorities. . . . Nor are we moved by the contention that the action of the taxpayers' bankers and brokers, in the way of submitting the affairs of the taxpayers to an unreasonable search, can deprive this man and his wife of their constitutional protection against unreasonable search. It is Zimmermann and his wife, and not their bankers and brokers, who are the real and aggrieved parties before us. To say that their bank accounts, withdrawals, their loans and collateral deposits, are the property of their bankers and brokers, and the taxpayers have no right or standing to prevent an unreasonable search thereof, is to lose sight of substance and rest on shadow" (*Id.* at 848).

Finally, the Court ruled:

> "It is the right of the taxpayers . . . that is here involved. It is the information the bankers' books contain, and not the books in which that information is recorded, that is the property right of these taxpayers, a property right this Court protects by injunctive relief" (*Id.* at 849).

The Circuit Court below noted the *Zimmermann* holding but stated that it was modified by the Third Circuit's later opinion in the same case reported at 105 F. 2d 583 (1939) (R. 140 n. 11). However, the matter relied upon by the Court below as constituting the modification was mere dictum (*Id.* at 586). The second opinion in *Zimmermann* involved an appeal by the taxpayer after the Government

had answered the complaint and made a showing which, the Court found, established reasonable grounds to believe that there was fraud. The District Court herein properly analyzed these cases when it stated:

> "The first Zimmerman vs. Wilson case, supra, establishes that the information contained in the third parties' books concerning the taxpayer is a 'property right of the taxpayer' that the Court will protect, and this concept is not disturbed by the decisions in the subsequent hearings on the same cause, although the holding of the initial case is weakened by the later decisions and the dicta contained therein" (R. 38-39; App. D, p. 23a).

See also, Note, 60 Mich. L. Rev. 781, 791 (1962).

The sufficiency of petitioners' interest in the bank's records is also supported by *Brex* v. *Smith*, 146 Atl. 34 (N. J. Ch. 1929). There, in granting the depositor an injunction to prevent a bank's disclosure of information in its records concerning transactions by and with the depositor, the Court stated:

> "It may be that the relation of a bank to its depositors is that of debtor and creditor, but I think it is more than that. As far as the money actually deposited is concerned, that is true. But, as to the records of the accounts, the deposits and withdrawals, that is another matter. There is an implied obligation, as I see it, on the bank, to keep these from scrutiny until compelled by a court of competent jurisdiction to do otherwise. *The information contained in the records is certainly a property right*" (146 Atl. at 36) (emphasis added).

And see 73 Banking L. J. 163 (1956); Note, 45 Yale L. Rev. 1523, 1526 (1936).

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted.

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New York, N. Y.
May 23, 1963

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APPENDIX A

Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PERRY A. DEMASTERS, et al., *Appellants,* v. EGON D. AREND and MELA K. AREND, *Appellees.*	No. 17,796

APPEAL from the United States District Court for the District of Oregon.

THIS CAUSE came on to be heard on the Transcript of the Record from the United States District Court for the District of Oregon and was duly submitted.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed.

Filed and entered January 24, 1963.

APPENDIX B

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

PERRY A. DEMASTERS, Internal Revenue Agent, Internal Revenue Service, ARTHUR G. ERICKSON, District Director of Internal Revenue, MORTIMER M. CAPLIN, Commissioner of Internal Revenue and THE UNITED STATES NATIONAL BANK OF PORTLAND (OREGON), *Appellants,* vs. EGON D. AREND and MELA K. AREND, *Appellees.*	No. 17,796 Jan. 24, 1963

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF OREGON

Before: MERRILL, BROWNING and DUNIWAY, Circuit Judges

BROWNING, Circuit Judge:

The District Court permanently enjoined appellants (employees of the Internal Revenue Service) from investigating possible income tax liability of appellee taxpayers for years as to which recovery would be barred by the statute of limitations in the absence of fraud. The Court also permanently enjoined the United States National Bank of Portland from disclosing to appellants any information

regarding transactions by or with the taxpayers during such years. We reject appellants' contention that a District Court has no power to issue such a restraining order in any circumstances, but we conclude that the Court lacked power to do so in the circumstances of this case.

The taxpayers'[1] 1946 and 1948 income tax returns were audited and their records for those years examined during 1948 and 1950. In 1957 appellant De Masters, an Internal Revenue agent, began a new investigation of the taxpayers' returns. It is stipulated that the period during which additional income tax could be assessed against taxpayers for any year prior to 1955 had expired, unless fraud were involved.[2] The taxpayers furnished De Masters with the information which he requested until he sought access to taxpayers' records without limitation as to date. Appellees' counsel then advised De Masters that in view of the prior audits and because the taxpayers were not charged with fraud they would not cooperate further in the investigation.

De Masters prepared tentative computations from various sources which indicated that the increase in the taxpayers' net worth, plus their estimated living expenses, during the period 1940 through 1956 totaled approximately $170,000. This increase, after appropriate adjustments, exceeded the income which the taxpayers reported during the same period for tax purposes by more than $90,000. He then examined records of a branch of the First National Bank of Portland reflecting deposits during 1948 to the account of taxpayers' shoe store, and found that they totaled

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[1]The taxpayers are husband and wife.

[2]If a false or fraudulent return with intent to evade the tax, or a willful attempt in any manner to defeat or evade tax, is involved, the tax may be assessed at any time. 26 U. S. C. A. §6501 (c)(1) and (2).